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Supreme Court of the United States

October Term, 1938.

No. 11.

Guy T. Helvering, Commissioner of Internal Revenue,
Petitioner,

v.

Robert C. Winmill, *Respondent*.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

SUPPLEMENTAL BRIEF FOR THE RESPONDENT.

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CASES CITED.

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ARGUMENT.

IV.

To the extent that Section 23 (r) of the Revenue Act of 1932 may be held by this court to disallow the buying commissions in the amount of $7,493.50, such Section is unconstitutional and void under Article I, Section 2, Clause 3 and Section 9, Clause 4 of the Constitution, because as so construed the Act levies a direct unapportioned tax on subject matter not contemplated by the word "incomes" within the meaning of the Sixteenth Amendment to the Constitution.

Supplementing respondent's argument set forth on pages 27 to 48, inclusive of his brief, and particularly with reference to the meaning of the word "incomes" as used in the Sixteenth Amendment to the Constitution, the atten-

tion of this court is respectfully called to the decision of the Supreme Judicial Court of Massachusetts in the case of *Trefry, Tax Commissioner* v. *Putnam*, 227 Mass. 521, 524, 116 N. E. 904, 907 (1917). In that case the court had before it the question of the meaning of the word "income" as used in the Forty-fourth Amendment to the Constitution of Massachusetts. The court said:

> " 'Income', like most other words, has different meanings dependent upon the connection in which it is used, and the result intended to be accomplished. * * * In its ordinary and popular meaning, 'income' is the amount of actual wealth which comes to a person during a given period of time. At any single moment a person scarcely can be said to have income. * * * It is common speech for one to say that he made so much money during a particular 12 months and to mean thereby that he has increased his wealth to that amount."

The court in its opinion referred to the meaning of the word "incomes" as used in the then recent Federal statutes and decisions of the Federal courts, including the 1913 law, which was passed under the Sixteenth Amendment to the United States Constitution, authorizing a tax only on "incomes." These Federal references to "incomes," the court stressed, may be presumed to have been familiar to the members of the general court and the people during the discussion accompanying the adoption of the Forty-fourth Amendment, and also that the interpretation of the word "incomes," as adopted by the Federal statutes "is matter of common knowledge." The court pointed further to the decisions under the Federal income tax law and limited the word "incomes" to that which during the year "was received and converted into cash" as distinguished from that which "would be known in common speech as mere paper profits."

On the basis of these reasons, briefly summarized above, the court reached the conclusion as to the meaning of the word "income" that:

"* * * the tax upon gains in excess of losses arising from sales of stock during the year 1916 is a tax upon income * * *."

From the foregoing it is clear that the word "income", in the sense most obvious to the common understanding at the time of the adoption of the Forty-fourth Amendment to the Massachusetts Constitution, would be identical with the meaning of the word "incomes" as commonly understood by the Congress and the people concerned at the time of the ratification of the Sixteenth Amendment to the Federal Constitution. And the meaning of the word "incomes" in the sense most obvious to the common understanding must have been briefly as follows:

> Income means the increase in one's wealth, arising from the excess, during a stated period of time, of gains from all sources over all losses in trade, with the understanding that the gains and losses must be realized gains and losses as distinguished from mere paper profits or losses.

This concept of income has been followed by the Supreme Judicial Court of Massachusetts in the following cases: *United States Trust Co. et al.* v. *Commissioner of Corporations and Taxation*, 13 N. E. (2d) 6, 8 (1938); *Bryant* v. *Commissioner of Corporations and Taxation*, 197 N. E. 509, 510; *Van Heusen* v. *Commissioner*, 257 Mass. 488, 154 N. E. 257; *Bingham et al.* v. *Long, Tax Commissioner*, 249 Mass. 79, 80; and *Brown* v. *Commissioner of Corporations and Taxation*, 242 Mass. 242, 244, 136 N. E. 188, 189.

In the light of these views, it is clear that the meaning of "income" most obvious to the common understanding, certainly does not contemplate a *net loss* of over a hundred thousand dollars. Therefore, during the year 1932 respondent did not have income in that sense which would produce a tax thereon in excess of a deficiency determined on the basis of the judgment of the court below.

V.

To the extent that the limitation provisions of Section 23 (r) and (t) of the Revenue Act of 1932 may be construed by this court as disallowing the buying commissions in the amount of $7,493.50, such provisions are unconstitutional and therefore void under the Due Process clause of the Fifth Amendment to the Constitution because they create arbitrary, whimsical, and capricious discrimination against persons whose activities consist in part or in whole of buying and selling securities for profit.

Supplementing respondent's argument set forth on pages 49 to 56, inclusive of his brief, particularly with respect to the discriminatory features of the Revenue Act of 1932, the deficiency on the basis of the judgment of the court below may not be increased.

> "In resolving the issue we are not concluded by the name or description of the tax as found in the Act; our duty is to ascertain its nature and effect." *Stewart Dry Goods Company* v. *Lewis*, page 555 of 294 U. S.

By its very nature, the Revenue Act of 1932 is not an income tax act, although its name and description so indicate. The reason for this statement is indicated by a statement of this court in *Stewart Dry Goods Co.* v. *Lewis*, at page 560 of 294 U. S. which is as follows:

> "An income levy by its very nature assures equality of treatment, because the burden of the exaction varies with increase or decrease of return on capital invested and with the comparative success or failure of the enterprise."

This test is not satisfied by the Revenue Act of 1932 insofar as respondent is concerned, because of the fact that although he sustained a substantial loss on his unsuccessful enterprises, under the Act he must pay tax on a substantial gain which was wiped out by the losses.

The important fact must not be lost sight of in this case
that the tax imposed upon respondent is a *graduated nor-*
al tax and surtax, as distinguished from the *flat rate cor-*
poration tax which alone was involved in *Helvering* v. *Inde-*
pendent Life Ins. Co., 292 U. S. 371, and *New Colonial Ice*
Co. v. *Helvering,* 292 U. S. 435. The imposition of such
graduated taxes is a discrimination against those who pay
a tax at a higher rate in favor of those who pay a tax at a
lesser rate. Such a discrimination it has been held by
abundant authority must bear some,

> "reasonable relation between the chosen criterion of classification and the privilege the enjoyment of which is said to be the subject taxed." *Stewart Dry Goods Co.* v. *Lewis,* 294 U. S. 550.

As pointed out by this court in that case, the doing of
exactly similar acts more oftener by one than another is
not a reasonable criterion for increasing graduations of
classifications.

The inequality may be justified only by the relative abil-
ity of persons more greatly discriminated against to pay.
This court in the *Stewart Dry Goods Co.* case, *supra,* held
the Kentucky graduated gross sales tax to be an arbitrary
and capricious discrimination offensive to the Fourteenth
Amendment to the Constitution, because among other things
one of the petitioners there for one year had a net income
of approximately $98,000, without the tax, but would have
had a loss of approximately $9,000 after deducting the
$107,000 tax demanded under the law. While the tax in the
instant case purports to be a *net income tax,* the limitation
of losses, provided for in Section 23 (r) (1) changes the
"nature and effect" of the tax to a *gross receipts tax.*

Specifically, respondent's activities from all sources re-
flected a loss of approximately $145,000, and yet under the
Commissioner's interpretation of the statute he would pay
a so-called "income tax" thereupon as though he had a net
income of approximately $35,000. The resulting discrimina-
tion here and the arbitrary and capricious burden imposed

bears no "reasonable relation between the chosen criterion of classification and the privilege" taxed. Certainly, if the graduated discriminatory tax in the *Stewart Dry Goods* case, *supra,* which was sufficient only "to make the difference between profit and loss," is arbitrary and offensive to the Fourteenth Amendment; an arbitrary discriminatory tax, which has the effect of *increasing a net loss already sustained,* must be even more offensive to the same principles and as such contrary to the due process provisions of the Fifth Amendment to the Constitution, which is a limitation upon the Federal taxing power. If such cases as *Brushaber* v. *Pacific Railway Co.,* 240 U. S. 1, *Stanton* v. *Baltic Mining Co.,* 240 U. S. 103, *Burnet* v. *Thompson Oil & Gas Co.,* 283 U. S. 301, are inconsistent with the *Stewart Dry Goods Co.* case, *supra,* it must be presumed that to the extent of such inconsistency they were overruled by the latter case.

Helvering v. *Independent Life Insurance Co.,* 292 U. S. 371, and *New Colonial Ice Co.* v. *Helvering,* 292 U. S. 435, are in no wise inconsistent with the *Stewart Dry Goods Co.* case, *supra,* because they involve only a non-discriminatory *flat rate corporation tax.* Whereas, the tax on respondent is a tax on an individual and is a discriminatory tax computed on the basis of graduated normal taxes and graduated surtaxes, having no relation to his ability to pay.

Respondent in discussing the similarity of the restraint in the fields of Federal and State action, imposed respectively by the Fifth and Fourteenth Amendments to the Constitution, did not point out that the *Stewart Dry Goods* case, *supra,* was decided by this court with reference to the "equal protection" clause of the Fourteenth Amendment without specific reference to the "due process" clause of that amendment.

It may be desirable, therefore, at this point to suggest what respondent believes to be the analogy indicated by the decisions of this court between the "equal protection" clause of the Fourteenth Amendment on the one hand and the "due process" clauses of the Fifth and Fourteenth Amendments on the other hand. From the cases decided

by this court and cited in respondent's brief (pages 49 to 55 incl.) it appears that the "arbitrary", "capricious" and "whimsical" character of a taxing law will be held offensive either under the equal protection clause of the Fourteenth Amendment or the due process clause of either the Fifth Amendment or the Fourteenth Amendment. No particular degrees of arbitrariness, capriciousness or whimsicality appear to have been defined as applicable to one clause or the other, and the conclusion is irresistible that what would be arbitrarily offensive to one would be arbitrarily offensive to the others. The same may be said of the interchangeable use (with relation to all these clauses) of references to classifications which are offensive because the means selected has no substantial relation between the chosen criterion of classification and the privilege. This, or a similar expression, is used by this court interchangeably with reference to the "equal protection" and the "due process" clauses of the Federal Constitution. That this reasoning is applicable to the Federal taxing power is indicated by such cases as: *Nichols* v. *Coolidge*, 274 U. S. 531; *Helvering* v. *Helmholz*, 296 U. S. 93; *Hassett* v. *Welch*, 303 U. S. 303, and *Heiner* v. *Donnan*, 285 U. S. 312.

While the foregoing discussion may not be necessary, respondent believes that it justifies the application to the Federal taxing power under the "due process" clause of the Fifth Amendment to the Constitution of everything which was said by this court with respect to the "equal protection" clause of the Fourteenth Amendment in the case of *Stewart Dry Goods Company* v. *Lewis, supra.*

The imposition of the arbitrary and discriminatory tax in question here may not be increased over the amount computed on the basis of the judgment of the court below. The judgment therefore should be affirmed.

Respectfully submitted,

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SUPREME COURT OF THE UNITED STATES.

No. 11.—October Term, 1938.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* Robert C. Winmill.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[November 7, 1938.]

Mr. Justice Black delivered the opinion of the Court.

Respondent—in his 1932 income tax return—deducted from his gross income brokerage commissions paid and incurred in purchasing securities during that taxable year. Section 23 (a) of the Revenue Act of 1932 allows as deductions "All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; . . . ." Respondent contends that he was engaged in the "business" of buying and selling securities and that the brokerage commissions amounted to "compensation for personal services actually rendered" within the meaning of Section 23 (a).

The Government insists that brokers' commissions in security purchases are "expenditures, . . . properly chargeable to capital account" constituting "a part of the cost" of such property and serving only to increase respondent's loss from sales of stock under Sections 111 and 23 (r) which control allowable losses on disposal of stocks.[1] Section 23 (r) allows losses on stock sales to be

[1] Revenue Act of 1932, c. 209, 47 Stat. 169, Sec. 111. Determination of Amount of Gain or Loss.

(a) Computation of Gain or Loss.—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b), and the loss shall be the excess of such basis over the amount realized.

Sec. 113. Adjusted Basis for Determining Gain or Loss.

(b) Adjusted Basis.—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

deducted only to the extent of gains realized from such sales. If respondent was engaged in the "business" of buying and selling securities, and the brokers' commissions were not a "part of the cost" of the securities purchased, but were ordinary business expenses [as defined in Section 23 (a)], respondent was justified in deducting the brokers' commissions from his gross income for the taxable year. However, if these commissions represent a part of the cost of the securities, respondent's right to deduct is limited by Section 23 (r).

The Commissioner refused to permit the deductions beyond the extent of stock losses. His action was affirmed by the Board of Tax Appeals.[3] The Court of Appeals held the commissions deductible if respondent was engaged in the business of buying and selling securities, and remanded for a finding as to the nature of his business.[4]

Article 282, Treasury Regulation 77, issued under the 1932 Act provides that "Commissions paid in purchasing securities are a part of the cost price of such securities." If this regulation governs, the respondent's contention cannot be sustained.

Regulations promulgated under the 1916 income tax law treated commissions in security purchases as a part of the securities' cost and not as ordinary expense deductions.[5] This interpretation has consistently reappeared in all regulations under succeeding tax

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(1) General Rule.—Proper adjustment in respect of the property shall in all cases be made—

(A) for expenditures, receipts, losses, or other items, properly chargeable to capital account, including taxes and other carrying charges on unimproved and unproductive real property, but no such adjustment shall be made for taxes or other carrying charges for which deductions have been taken by the taxpayer in determining net income for the taxable year or prior taxable years; . . .

[2] Revenue Act of 1932.

Sec. 23. Deductions from Gross Income. In computing net income there shall be allowed as deductions:

(r) Limitation on Stock Losses.

(1) Losses from sales or exchanges of stocks and bonds (as defined in subsection (t) of this section) which are not capital assets (as defined in section 101) shall be allowed only to the extent of the gains from such sales or exchanges (including gains which may be derived by a taxpayer from the retirement of his own obligations).

[3] 35 B. T. A. 804.

[4] 93 F. (2d) 494.

[5] See, Art. 8, Paragraph 108, T. R. 33 (Revised 1918).

statutes.[6] In the period since 1916 statutes have from time to time altered allowable deductions, but it is significant that Congress substantially retained the original taxing provisions on which these regulations have rested.

Treasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reenacted statutes, are deemed to have received congressional approval and have the effect of law.[7]

There has been tacit, if not express judicial approval for the administrative treatment of commissions as an element of the cost of securities. In *Hutton* v. *Commissioner*, 39 F. (2d) 459, 460, the Court of Appeals recognized that "It has long been a settled rule of the Treasury Department that commissions paid in purchasing securities are a capital expenditure as part of the cost price of the securities."

In recognition of this administrative regulation, it has been said here that " . . . commissions [paid for marketing bonds] do not differ from brokerage commissions paid upon the purchase or sale of property. The regulations have consistently treated such commissions, not as items of current expense, but as additions to the cost of property or deductions from the proceeds of sale, in arriving at net capital profit or loss for purposes of computing the tax."[8]

Respondent points to an apparent inconsistency between the general provision in Treasury Regulation 77, Article 121, that "Among the items included in business expenses are . . . commissions," and Article 282 which specifically and particularly declares that "Commissions paid in purchasing securities are a part of the cost price of such securities." Special provisions limit the application of those of a broad and general nature relating to the same subject. The special designation of security purchase commissions as a "part of the cost price of such securities" contained in Article 282 evinces the clear intent to withdraw that special

[6] Art. 293 of T. R. 45 (1918), 62 (1921); Art. 292 of T. R. 65 (1924), 69 (1926); Art. 282 of T. R. 74 (1928), 77 (1932); Art. 24-2 of T. R. 86 (1934), 94 (1936).

[7] United States v. Dakota Montana Oil Co., 288 U. S. 459, 466; Old Mission Co. v. Helvering, 293 U. S. 289, 293, 294.

[8] Helvering v. Union Pacific Co., 293 U. S. 282, 286.

type of commission from the general classification of Article 111.

Nor can it be inferred that the addition of Section 23 (r) to the 1932 Act indicated any congressional purpose to alter or repeal the long existing administrative interpretation of non-deductible capital expenditures under which brokers' purchase commissions have been uniformly considered as a part of the cost of securities and not as current business expenses. This new statutory restriction of the allowance for losses from sales of stock bears no such relationship to the definition of cost price of securities as to lead to the conclusion that Congress intended to overthrow and abandon a settled practice of determining the elements of cost.

The brokers' purchase commissions here constituted a part of the acquisition cost of the securities involved, and are not allowable to the taxpayer as a deduction from gross income under Section 23 (a) of the Revenue Act of 1932. Congress, in the exercise of its power to deny or limit deductions from gross income,[9] has—by Section 23 (r)—limited this taxpayer's allowable deduction. He has a right to a deduction "only to the extent of . . . gains from . . . sales or exchanges of stocks and bonds" as therein provided. The fact—if it be a fact—that respondent was engaged in the business of buying and selling securities does not entitle him to take a deduction contrary to this provision.

The cause is reversed and remanded to the Court of Appeals for action in harmony with this opinion.

Reversed.

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[9] Similarly, if the specific provisions of Article 282 are valid and have the present effect of law, respondent's contention that the commissions are uncompensated losses within the meaning of the general provisions of Section 23 (e) (1) of the 1932 Act is unavailing.

[10] See, Helvering v. Ind. Life Ins. Co., 292 U. S. 371, 381.